

# Acquisition and Target Manager's Remuneration: The Generosity Game\*

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## Abstract

This project fosters the comprehension of acquiring and target CEO's faith pre and post-acquisition. The motives for undertaking a merger or an acquisition have been extensively studied: increasing the stock value, taking over of a geographic market, diversifying the activities of the firm (risk sharing), benefiting from economies of scale/scope or other types of efficiencies, or simply because of managerial hubris.

On the target side, the situation is less well understood. The shareholders are always strictly better off as acquiring firms pay a premium for the acquisition. Wulf (2004) and Hartzell et al.(2004) argue that target CEOs trade lower bid for control (retention). Hence, there is an inverse relation between the value paid by acquiring firm and the level of control handed in to the target CEO post-acquisition. Similarly, Fich et al.(2009) study unscheduled stock option granted during private merger and acquisition negotiations. Behind this generosity game lies the fact that the target CEO's approval is crucial to insure credibility from the shareholders and external agents as well as for its role in minimizing the premium paid (Fich et al.,2009). Based on this empirical literature, I develop a theoretical framework explaining the puzzling result that target CEO gain from acquisition based on this "generosity game".

The acquiring board proposes a financial package or a role in the new firm to influence the value of the accepted bid. On the other side, the target board presents an offer to the target CEO using unscheduled stock options or other financial assets at their disposition. CEOs care about the repercussions of their actions (career concerned) and modeled using Hermalin and Weisbach (1998).

The main result of this project is to derive conditions under which it is optimal to both target and acquiring board of directors to participate in the generosity game. These conditions depend on CEOs' perceived ability, directors' level of independence and other information variables.

The framework can be extended in several directions and much work remained to be done.

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